Our discussion and analysis of the Tennessee Housing Development Agency's financial performance provides an overview of the agency's financial activities for the years ended June 30, 2004 and June 30, 2003. Please read it in conjunction with the agency's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

Year Ended June 30, 2004

- Cash and cash equivalents increased $9.9 million
- Investments decreased by $73.2 million
- Bonds and notes payable decreased $58.0 million
- The agency's total net assets decreased $7.6 million
- The agency originated $273.2 million in mortgage loans

Year Ended June 30, 2003

- Cash and cash equivalents increased $101.5 million
- Investments decreased by $64.0 million
- Bonds and notes payable decreased $67.7 million
- The agency's total net assets increased $35.7 million
- The agency originated $158.9 million in mortgage loans

OVERVIEW OF THE FINANCIAL STATEMENTS

The basic financial statements include statements of net assets, statements of revenues, expenses and changes in net assets, statements of cash flows and notes to the financial statements. The statements of net assets provide financial information on the overall financial position of the agency at each year end. The statements of revenues, expenses and changes in net assets summarize the results of operations over the course of each fiscal year. The statements of cash flows provide relevant information about the agency's cash receipts and cash payments during each fiscal year. The notes to the financial statements provide useful information regarding the agency's significant accounting policies, significant account balances and activities, certain material risks, obligations, commitments, contingencies and subsequent events. The agency's financial statements are presented using the accrual basis of accounting and the flow of economic resources measurement focus. In addition to the basic financial statements, other supplementary information is also included.

FINANCIAL ANALYSIS OF THE AGENCY

Net Assets. The following table focuses on the changes in net assets between fiscal years (expressed in thousands):

	2004	2003	2002
Current assets	$ 459,245	$ 486,913	$ 356,230
Capital assets	16	-	5
Other noncurrent assets	1,765,131	1,813,491	2,014,871
Total assets	2,224,392	2,300,404	2,371,106
Long-term liabilities	1,784,774	1,839,174	1,840,205
Other liabilities	41,543	55,514	160,902
Total liabilities	1,826,317	1,894,688	2,001,107
Invested in capital assets	16	-	5
Restricted net assets	388,913	396,203	359,618
Unrestricted net assets	9,146	9,513	10,376
Total net assets	$ 398,075	$ 405,716	$ 369,999

2004 to 2003

- The agency's total net assets decreased $7.6 million from $405.7 million at June 30, 2003 to $398.1 million at June 30, 2004. This primarily resulted from the decrease in the fair value of investments.

- Mortgage loans receivable decreased $9.3 million from $1,426.3 million at June 30, 2003 to $1,417.0 million at June 30, 2004. The decrease resulted from loan prepayments exceeding loan originations.

- Total liabilities decreased $68.4 million from $1,894.7 million at June 30, 2003 to $1,826.3 million at June 30, 2004. The decrease is primarily due to the retirement of debt.

2003 to 2002

- The agency's total net assets increased $35.7 million from $370.0 million at June 30, 2002 to $405.7 million at June 30, 2003. This increase resulted from the normal operations of the agency and an increase in the fair value of investments.

- Mortgage loans receivable decreased $111.1 million from $1,537.4 million at June 30, 2002 to $1,426.3 million at June 30, 2003. The decrease resulted from loan prepayments exceeding loan originations.

- Total liabilities decreased $106.4 million from $2,001.1 million at June 30, 2002 to $1,894.7 million at June 30, 2003. The decrease is primarily due to the retirement of debt.

Changes in Net Assets. The following table summarizes the changes in revenues, expenses and changes in net assets between fiscal years (expressed in thousands):

	2004	2003	2002
Operating revenues			
Mortgage interest income	$ 93,763	$ 104,714	$ 107,134
Investment income (loss)	(67)	48,538	45,131
Other	12,174	11,055	9,908
Total operating revenues	105,870	164,307	162,173
Operating expenses			
Interest expense	83,326	102,164	102,413
Other	24,005	19,772	18,569
Total operating expenses	107,331	121,936	120,982
Operating income (loss)	(1,461)	42,371	41,191
Nonoperating revenues (expenses)			
Grant revenues	143,630	138,123	127,611
Grant expenses	(149,810)	(144,777)	(137,638)
Payment to primary government	-	-	(35,367)
Total nonoperating revenues (expenses)	(6,180)	(6,654)	(45,394)
Changes in net assets	$ (7,641)	$ 35,717	$ (4,203)

2004 to 2003

For the year ended June 30, 2004, total operating revenues decreased $58.4 million from $164.3 million for the year ended June 30, 2003 to $105.9 million for the year ended June 30, 2004. The primary reasons for this decrease are as follows:

- Mortgage interest income decreased $10.9 million, from $104.7 million in 2003 to $93.8 million in 2004. This is due to mortgage loan prepayments of higher interest loans, as well as new loans originated at record-low rates.

- Investment income decreased $48.6 million, from $48.5 million in 2003 to a net loss of $67,000 in 2004. This decrease is due to a net decrease in the fair value of investments of $22.2 million in 2004 (as compared to a net increase of $18.1 million in 2003) as well as higher coupon investments that were called, which were subsequently re-invested into investments having a lower interest rate.

For the year ended June 30, 2004, total operating expenses decreased $14.6 million, from $121.9 million in 2003 to $107.3 million in 2004. This decrease is primarily due to a decrease in interest expense of $18.8 million, from $102.1 million in 2003 to $83.3 million in 2004. This decrease occurred as a result of the Agency continuing to use mortgage loan prepayments to call higher-interest bonds.

2003 to 2002

For the year ended June 30, 2003 total operating revenues increased $2.1 million from $162.2 million for the year ended June 30, 2002 to $164.3 million for the year ended June 30, 2003. The primary reasons for this increase are as follows:

- Mortgage interest income decreased $2.4 million from $107.1 million for the year ended June 30, 2002 to $104.7 million for the year ended June 30, 2003. The decrease resulted from the prepayments of higher yielding loans and a decrease in loans outstanding.

- Investment income increased $3.4 million from $45.1 million for the year ended June 30, 2002 to $48.5 million for the year ended June 30, 2003. The increase resulted from an increase in the fair value of investments.

For the year ended June 30, 2003, total operating expenses increased $.9 million, from $121.0 million in 2002 to $121.9 million in 2003.

Under Chapter 825, Public Acts of 2002 and section 9.(2) of Chapter 827, Public Acts of 2002, for the sole purpose of meeting the requirements of funding the operations of the primary government for the fiscal year ended June 30, 2002, a payment in the amount of $35.4 million was authorized from the agency's net assets. This transfer was reported as a non-operating expense for the year ended June 30, 2002.

DEBT ACTIVITY

Bonds and notes outstanding at June 30 were as follows (expressed in thousands):

	2004	2003	2002
Bonds payable	$1,489,299	$1,769,506	$1,820,394
Notes payable	273,240	51,070	67,909
Total bonds and notes payable	$1,762,539	$1,820,576	$1,888,303

Year Ended June 30, 2004

Total bonds and notes payable decreased $58.0 million due primarily to retirement of debt. During the fiscal year, the agency issued debt totaling $741.0 million, with activity arising from four bond issues totaling $406.9 million and four draws under the single family mortgage note program totaling $334.1 million.

Year Ended June 30, 2003

Total bonds and notes payable decreased $67.7 million due primarily to retirement of debt. During the fiscal year, the agency issued debt totaling $211.7 million, with activity arising from two bond issues totaling $135.0 million and two draws under the single family mortgage note program totaling $76.7 million.

Note Authority

On March 18, 2004, the agency's board of directors authorized the issuance of Single Family Mortgage Note, Series 2004CN-1. This $450 million drawdown note with a maturity of up to three years closed on August 31, 2004.

ECONOMIC FACTORS

Fiscal Year 2004 saw a continuation of record-low interest rates. As a result, the agency continued to see mortgage loan prepayments, whereas new mortgages were originated at record low interest levels. Likewise, the agency continued to experience advanced calls of its bond investments. The proceeds from these calls were subsequently reinvested into investments with lower yields. In addition, market values of investments declined as a result of the drop in interest rates. Because of these external market influences, the agency continued to call higher-interest debt.

CONTACTING THDA's FINANCIAL MANAGEMENT

This financial report is designed to provide the agency's stakeholders with a general overview of the agency's finances and to show accountability for the funds that it receives, invests, and expends. If you have questions about this report, or need additional financial information, contact Ted Fellman, CPA, Chief Financial Officer at (615) 741-1104 or via e-mail at Ted.fellman@state.tn.us.